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688740—46

In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 921

WICHITA COCA COLA BOTTLING COMPANY,
PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 16–18) is reported at 61 F. Supp. 407. The opinion of the Circuit Court of Appeals (R. 25–28) is reported at 152 F. 2d 6.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 10, 1945. (R. 29.) The petition for a writ of certiorari was filed March 7, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the sum of $9,111.40, built up over a period of years in petitioner's liability reserve account designated "Deposit on Cases and Bottles" and upon which no federal income tax had ever been paid, was taxable as income to petitioner in 1940, the year in which such sum was transferred to surplus from the reserve account.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> (26 U. S. C., Sec. 22.)

STATEMENT

The facts are all stipulated (See R. 8–16) and were found as stipulated by the District Court (R. 17). They may be summarized as follows:

The petitioner, Wichita Coca Cola Bottling Company, was incorporated in Texas and has its

principal place of business at Wichita Falls, Texas. Since its incorporation in 1919, it has been engaged in the business of bottling and distributing Coca Cola and other soft drinks. Each type of drink made by petitioner had a distinctively shaped bottle and had its name imprinted in the glass. All of the cases had the wording "Drink Coca Cola in Bottles" stenciled on the outside of the cases. About 60% of such cases also had the letters "WFCC" stenciled on the outside; approximately 40% of the cases had the wording "Wichita Coca Cola Bottling Company, Wichita Falls, Texas," stenciled on the inside. (R. 9, 11.)

From its inception in 1919 through 1939 petitioner had a reserve account set up for deposits on cases and bottles taken out by customers. The account was generally designated as "Deposit on Cases & Bottles." (R. 9.) When cases and bottles were delivered to a customer, a deposit of 50 cents per case was required of him. This deposit was credited to the reserve account, while the amount received for the beverage itself was credited to the sales account. If and when cases and bottles were returned, the deposit was returned to the customer or to whoever brought them in to petitioner, and the reserve account was thereupon debited. (R. 10.)

In its federal income tax returns petitioner set up expenses for cases and bottles and listed the

reserve account under "Other Liabilities." The return for 1919 covered only the last 16 days of 1919 and did not include any balance sheet or break-down of costs of goods sold. (R. 9.) The 1920 return listed as an expense "Cases and Bottles, replacing wastage, etc.—$20,186.31." In a letter dated December 8, 1921, Deputy Commissioner E. H. Batson inquired of petitioner if the item represented the amount of actual loss sustained on account of bottle breakage and losses or if it also included purchases of cases and bottles which should be included in inventories. By letter dated December 24, 1921, A. M. Biedenhorn, then petitioner's secretary and treasurer, replied that petitioner carried an account "Cases and Bottles" to which all purchases of cases and bottles were debited, that upon closing its books an inventory of all cases and bottles was taken and credited to such account, and that the resultant difference represented the value of cases and bottles lost. (R. 14–15.)

In connection with the audit of the 1924–1926 returns, the Bureau of Internal Revenue questioned the reserve account and the apparent reduction of income by the annual increase in that account. An agent who investigated reported that no part of the account was charged to profit and loss since the money was collected to insure return of the containers and would ultimately be returned 100 cents on the dollar. (R. 15.)

An inventory of the cases and bottles was taken each year, but this inventory did not include the cases and bottles which had been delivered to the customers and which had not been returned at the time of the inventory. (R. 11.)

E. A. Denny, who became petitioner's manager in 1930, knew from past experience that the amount credited to the reserve account each year was in excess of the amount which would have to be paid out on account of the return of cases and bottles. This he knew to be true because there was always breakage or destruction of bottles and cases in the hands of customers, because of his previous experience and because of his knowledge of the increase in the account each year reflected by the books. (R. 12.)

As a result of the non-return of cases and bottles, the reserve listed in petitioner's federal income tax returns for the years 1919 through 1939 increased from year to year. (R. 11–12.) At the end of the year 1939 the credit balance in this account was $10,261.32. (R. 13.)

In 1940 Internal Revenue Agent Jarrett made an audit of petitioner's 1937, 1938 and 1939 income tax statements. In the audit he determined that the increase in the size of the credit balance in the reserve account for each of those years was income and corrected the income tax returns which had previously been filed by petitioner by including in the income for 1937 a profit of $421.45; for the year 1938 a profit of $569.47, and

for the year 1939 a profit of $159, making a total correction of $1,149.92, which is the amount the reserve account increased during the years 1937 to 1939, inclusive. When the agent charged these items to profit for each of those years, an adjustment was made debiting the reserve account for this amount and crediting that amount to profit for the several years. After this debit had been made, the balance of the account at the beginning of 1940 was $9,111.40. (R. 13.)

In 1940 petitioner debited the account called "Deposit on Cases and Bottles" with $9,111.40, which took the reserve account off the books, and credited the same amount to surplus. In its return for 1940 petitioner did not treat the amount of $9,111.40 as income for that year. As a result of an audit made of the return by an internal revenue agent, a deficiency of $2,058.42 in tax and $129.93 in interest, or a total of $2,188.35, was assessed against petitioner for 1940 based on the inclusion of the item of $9,111.40 in petitioner's income for that year. (R. 13–14.)

The 1940 deficiency was subsequently paid by petitioner. (R. 13.) The petitioner thereupon filed a claim for refund which was rejected by the Commissioner. (R. 14.) This suit for a refund was instituted on November 30, 1944. (R. 1.) The District Court denied recovery. (R. 16–19.) On appeal, the Circuit Court of Appeals affirmed the action of the District Court. (R. 25–29.)

ARGUMENT

The decision below is merely an application of well established legal principles and is correct on any one of several grounds. The possibility of conflict with *Northwestern States Portland Cement Co.* v. *Huston*, 126 F. 2d 196 (C. C. A. 8th), on *one* of the grounds is insufficient, we submit, to warrant further review of the case by this Court.

Petitioner's reserve account entitled "Deposit on Cases & Bottles" represented its contingent liability for refunds of deposits it had received for cases and bottles. Since more cases and bottles were delivered than were returned for refund, the balance in the reserve account steadily increased over the years. This excess reserve represented receipts on which no income tax had been paid, for taxpayer had set up the account and treated the balance in it as a liability instead of treating the transactions with respect to cases and bottles as sales and including the receipts therefrom in income or instead of including the value of the outstanding cases and bottles in an inventory account to offset the reserve account. In 1940, after an internal revenue agent had adjusted petitioner's returns for 1937–1939, inclusive,[1] petitioner transferred the remaining balance in the reserve account,

[1] The fact that an adjustment in petitioner's returns was made on one theory for certain years does not, of course, preclude the Commissioner from an examination and determination of tax liability on a different theory for another year. See *Burnet* v. *Porter*, 283 U. S. 230.

the excess reserve, to its surplus account. It is well settled that the excess in a reserve account is to be treated as income in the year it is released, since it then for the first time becomes available as free income. *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, 352; *Boston Consol. Gas Co.* v. *Commissioner,* 128 F. 2d 473 (C. C. A. 1st); *Commissioner* v. *Dallas Title & Guar. Co.,* 119 F. 2d 211 (C. C. A. 5th); *North American Coal Corp.* v. *Commissioner,* 97 F. 2d 325 (C. C. A. 6th); *Chicago, R. I. & P. Ry. Co.* v. *Commissioner,* 47 F. 2d 990 (C. C. A. 7th), certiorari denied, 284 U. S. 618; *Virginia Iron Coal & C. Co.* v. *Commissioner,* 99 F. 2d 919 (C. C. A. 4th), certiorari denied, 307 U. S. 630; *Warren Service Corp.* v. *Commissioner,* 110 F. 2d 723 (C. C. A. 2d).

While it may have been possible for petitioner to have handled the transactions in cases and bottles in a different manner and to have reported the income from the transactions on a yearly basis, petitioner is in no position now, after the statute of limitations has run as to prior tax years, to contend, as it has (see R. 27), that its receipts for the cases and bottles were receipts from sales, not deposits, and that the receipts were taxable in years now barred from assessment. Not only did petitioner represent such receipts as deposits subject to refund, but, knowing that the reserve was in excess of what would actually have to be paid out as refunds, its officers misrepresented the reserve account to internal revenue

officers, once by asserting that the account represented only lost bottles and that its inventories were consistent with its treatment of the account and once by persuading an agent that the existence of the account had no effect on profit and loss with respect to the 1924–1926 returns. Even assuming that petitioner's treatment of these deposits was wrong, it is well settled that a taxpayer is not permitted to found a claim upon his own inequity or to take advantage of his own wrong. *Stearns Co.* v. *United States,* 291 U. S. 54, 61–62; *Higgins* v. *Smith,* 308 U. S. 473, 477; *Becker* v. *Bemis,* 104 F. 2d 871, 876 (C. C. A. 8th), certiorari denied, 308 U. S. 613; *Robinson* v. *Commissioner,* 100 F. 2d 847 (C. C. A. 6th), certiorari denied, 308 U. S. 567; *Commissioner* v. *Liberty Bank & Trust Co.,* 59 F. 2d 320 (C. C. A. 6th); *Orange Securities Corp.* v. *Commissioner,* 131 F. 2d 662 (C. C. A. 5th); *Alamo Nat. Bank* v. *Commissioner,* 95 F. 2d 622 (C. C. A. 5th), certiorari denied, 304 U. S. 577, rehearing denied, 304 U. S. 590.

Northwestern States Portland Cement Co. v. *Huston, supra,* is distinguishable on its facts. In that case the taxpayer had, at different times, transferred funds from its surplus account to a reserve account entitled "Reserve for Loss on Sacks" to cover its anticipated losses on the return of cement sacks. In 1932, when the taxpayer ascertained that the reserve was excessive and transferred $75,000 back to surplus, the Commis-

sioner sought to tax this $75,000 as income. The court's ultimate conclusion was that income was realized by the taxpayer in each prior year to the extent that the reserves exceeded actual liability in that year, not by the book transfer of what had always been a part of the taxpayer's surplus account. The transactions in sacks were treated by the taxpayer as sales, rather than as deposits, as here.[2] In any event, while the court's conclusion as to the sack transactions may perhaps be deemed inconsistent with the decision below, the ultimate reason for the result reached was that no contention was made that the taxpayer had ever misrepresented to the Commissioner or his agents any facts with respect to the reserve account or that the Commissioner, in reviewing and auditing the taxpayer's returns and books, did not ascertain the nature of the liability which the reserve account was set up to reflect. In the instant case the nature of petitioner's "Deposits on Cases & Bottles" account was obscure and petitioner's officers made misrepresentations in regard to it. The *Northwestern States Portland Cement Co.* case was decided by the Circuit Court of Appeals

[2] It appears to be quite common to treat transactions in cement sacks as sales. See *Dewey Portland Cement Co.* v. *Crooks*, 57 F. 2d 499 (C. C. A. 8th); *La Salle Cement Co.* v. *Commissioner*, 59 F. 2d 361 (C. C. A. 7th), certiorari denied, 287 U. S. 624. Experience has taught that about 90% of the cement sacks are returned for refund. *Alpha Portland Cement Co.* v. *United States*, 67 C. Cls. 680; *La Salle Cement Co.* v. *Commissioner*, *supra*.

for the Eighth Circuit and that court is in agreement with the court below as to the law of equitable estoppel as applied in tax cases. Cf. R. 28 with *Becker* v. *Bemis, supra,* pp. 875–876.

CONCLUSION

The decision below is correct. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APRIL, 1946.

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